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No. 96-1161

In The

Supreme Court of the United States

October Term, 1996

MOHAMMAD SAMIH BARAKAT,

Petitioner,

v.

THE LIFE INSURANCE COMPANY OF VIRGINIA,

Respondent.

Petition For Writ Of Certiorari
To The United States Court Of Appeals
For The Ninth Circuit

REPLY TO BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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REPLY TO BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Petitioner MOHAMMAD SAMIH BARAKAT ("Barakat") hereby replies to the "Brief in Opposition to Petition for Writ of Certiorari" ("Opposition") filed by Respondent THE LIFE INSURANCE COMPANY OF VIRGINIA ("LICV").

I. LICV'S RE-STATEMENTS OF THE QUESTIONS PRESENTED AND STATEMENT OF THE CASE ARE INACCURATE AND INCOMPLETE.

LICV's re-statement of the questions presented (Opposition, pg. i) is markedly incomplete for three reasons.

First, there is Circuit-level disagreement about the threshold question of whether a deficiency claim is "substantially similar" to other unsecured claims, and *can* be classified with such claims under 11 U.S.C. §1122(a).[1] In the Seventh Circuit, under *Matter of Woodbrook Assocs.*, 19 F.3d 312 (7th Cir. 1994), the issue presented by LICV would never be reached.

Second, numerous lower courts have held,[2] and scores of commentators have opined,[3] that even if a deficiency claim *could* be classified with general unsecured claims, there is no Code *requirement* compelling such classification. Therefore, the second question stated by Barakat – whether the Code requires that all similar claims be classified together absent some business justification – is another threshold question.

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[1] All statutory references herein are to the Bankruptcy Code (Title 11, United States Code) ("the Code").

[2] See, e.g., *In re ZRM-Oklahoma Partnership,* 156 B.R. 67 (Bankr. W.D. Ok. 1991); *In re SM 104, Ltd.*, 160 B.R. 202 (Bankr. S.D. Fla. 1993); *In re Rivers End Apartments, Ltd.*, 167 B.R. 470 (Bankr. S.D. Oh. 1994). Also see, *In re Baldwin Park Towne Center, Ltd.*, 171 B.R. 374 (Bankr. C.D. Cal. 1994) and the Bankruptcy Court Opinion below (Appendix, pages A-61, 65-66) reported at 173 B.R. 672 (Bankr. C.D. Cal. 1994).

[3] See articles cited in Petition, pgs. 22-23, n. 2.

Finally, even in jurisdictions which require the showing of an independent business or economic justification for separate classification of deficiency claims, substantial disagreement exists about what constitutes such justification. There is no dispute that all six factors which justified separate classification in *Baldwin Park,* 171 B.R. at 377 were (and are) present in this case.[4] Courts continue to grapple with the difficulties of enforcing ill-defined standards for "business or economic justification" for separate classification.

Accordingly, LICV's re-statement of the questions presented by the Petition is misleading. The "Questions Presented" by Barakat in the Petition (pg. 1) are accurate.

LICV's addition to Barakat's "Statement of the Case" is also misleading. While it is true that the Bankruptcy Court found no justification for separate classification, it is equally true that all six *Baldwin Park* factors were present here.

II. THE PETITION PRESENTS A CIRCUIT-LEVEL DISAGREEMENT ON A SIGNIFICANT ISSUE OF FEDERAL LAW.

LICV asserts that "the Petition does not present a significant issue of federal law, but rather only Barakat's failure to meet the factual requirements of the applicable standard of law." (Opposition, pg. 2). This is plainly not so. Whether Barakat failed to meet factual requirements of "the applicable standard of law" cannot be answered until this Court resolves the conflict among the Circuits (and lower courts and commentators) on the applicable standard of law.

In its decision here, the Ninth Circuit joined the majority of Circuits, led by the Fifth Circuit in *In re Greystone III Joint Venture,* 995 F.2d 1274 (5th Cir. 1991), in holding that it is impermissible to separately classify a §1111(b) deficiency claim without an independent justification. As the Bankruptcy Court below noted, the Ninth Circuit's decision is "diametrically opposed" to that of the Seventh Circuit in

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[4] The *Baldwin Park* factors, and their undisputed presence in this case, are described in the Petition at pgs. 24-25.

Woodbrook, which held that such a claim *cannot* be classified with other unsecured claims. (Appendix, pg. A-65).

Further, the issue of federal law presented by this Petition is significant enough to have been referred to as a "hot topic" by the Bankruptcy Court below (Appendix, pg. A-65), and to have been the subject of scores of reported cases and hundreds of legal journal articles. (Petition, pgs. 21-23). Widespread litigation on this issue is driven not by mere academic interest but by the substantial economic impact of its consequences on deficiency claimholders (typically financial institutions), other unsecured creditors (typically small, locally-based businesses), and individual and small partnership debtors and their employees.

III. REGARDLESS OF WHETHER IT IS THE SEVENTH CIRCUIT OR NINTH CIRCUIT WHICH HAS MISINTERPRETED THE BANKRUPTCY CODE, CERTIORARI IS APPROPRIATE.

The Ninth Circuit here decided that the Seventh Circuit misinterpreted the Code in *Woodbrook*. Barakat believes that the Ninth Circuit misinterprets the Code here, and that the Seventh Circuit is correct. For purposes of this Petition, however, this conflict need only be noted, not resolved. Certiorari is appropriate because, as LICV *admits*, the Ninth Circuit and Seventh Circuit decisions are in direct and irreconcilable conflict.

Moreover, as described below, none of the substantive bases on which LICV attacks *Woodbrook* withstand analysis.

A. Other Sections of the Bankruptcy Code Are Not Ignored or Rendered Meaningless by a "Plain Meaning" Reading of §1122(a).

LICV contends that the reading of the plain meaning of §1122(a) advocated by Barakat is incorrect, because it is an analysis "in a vacuum, ignoring other sections of the Bankruptcy Code" (Opposition, p. 4), citing *United Savings Ass'n v. Timbers of Inwood Forest,* 484 U.S. 365 (1988). However,

Timbers is inapposite, because §1122(a) clearly and unambiguously does *not* require that similar claims be classified together. Therefore, §1122(a) need not be "clarified by the remainder of the statutory scheme."

This Court has noted that the Code is the result of Congressional compromises concerning the competing interests of various parties in a bankruptcy case. *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 61 n. 12 (1982). This Court has found that the Code as a whole is coherent and consistent. Accordingly, this Court repeatedly looks to the plain meaning of individual provisions to interpret their meaning. *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 240-41 (1989); *Union Bank v. Wolas*, 502 U.S. 151 (1991). If a restriction is not present in the express language of a statute, this Court will not "create a distinction the words of the statute do not contain." *Owen v. Owen*, 500 U.S. 305, 313 (1991). See also, *Toibb v. Radloff*, 501 U.S. 157 (1991); *Patterson v. Shumate*, 504 U.S. 753 (1992).

However, even if it were proper for this Court to examine other statutes within the Code in interpreting §1122(a), the Ninth Circuit's conclusion here does not withstand analysis.

The Ninth Circuit endorsed the notion that §1122(b) would be rendered meaningless if §1122(a) allows a debtor to separately classify similar claims. (Appendix, pg. A-11; Opposition, pgs. 5-6). This contention overlooks the analysis set out in *ZRM-Oklahoma*, 156 B.R. at 70 (Petition, pgs. 18-19).

The Ninth Circuit also accepted *Greystone*'s proposition that "§1111(b)(2) would become meaningless if §1122(a) is interpreted to allow for the separate classification of a secured creditors' deficiency claim." (Opposition, pg. 6; Appendix, pg. A-14). Insistence on classifying §1111(b) claims with other claims leads to bizarre anomalies in the application of §1111(b). (Petition, pgs. 19-20).

Further, *Greystone*'s analysis of the §1111(b) election as a basis for reading into §1122(a) a requirement that all unsecured claims be grouped together does not withstand scrutiny. The Fifth Circuit started with the following notion: "Generally, the creditor may elect recourse status and obtain

the right to vote in ***the*** unsecured class, or it may elect to forego recourse to gain an allowed secured claim for the entire amount of the debt." 948 F.2d at 140 (emphasis added). In fact, §1111(b) does not address whether a creditor electing recourse status has a right to vote in any class, much less in "***the***" unsecured class, which assumes without analysis that there can (or should) be only one unsecured class.

The Circuit-level cases that follow *Greystone* are based on the same fallacy that §1111(b) implies a right to vote *with* (i.e., in the same class as) other unsecured creditors, not just a right to vote an unsecured claim. *In re Boston Post Rd. Ltd. Partnership,* 21 F.3d 477, 483 (2d Cir. 1994); *In re Lumber Exchange Bldg. Ltd.,* 968 F.2d 647, 649-50 (8th Cir. 1992).

B. The Bankruptcy Code Is Consistent with Allowing Separate Classification of Deficiency Claims.

Although the Ninth Circuit did not so hold, LICV argues, without case authority or other support, that allowance of separate classification pursuant to the plain meaning of §1122(a) would violate §§1129(a) and (b). LICV's argument is that by allowing separate classification, a debtor could separately classify every creditor, hoping to get at least one vote in favor of the plan, and thereby to obtain the accepting class required by §1129(a)(10).

The argument that allowing separate classification would lead to the proliferation of plans with all claims separately classified ignores plan proponents' reluctance to create multiple classes due to the leverage available to each dissenting class. Every dissenting class is protected separately by §1129(b). Every class has the right to contend that discrimination between it and the other classes is "unfair" and that the plan is not "fair and equitable." Every class is entitled to protection of the absolute priority rule. Underlying all of these protections is the fact that the burden of proof is on the proponent to show that the requirements of §1129(b) have been satisfied as to every class. *In re Arnold and Baker Farms,* 177 B.R. 648, 654 (Bankr. 9th Cir. 1994).

It is precisely because of these protections that allowing separate classification of claims does not result in the automatic confirmation of any given plan. See, *In re U.S. Truck Co., Inc.*, 800 F.2d 581, 587 (6th Cir. 1986); *Rivers End, supra*; *In re BMW Group I, Ltd.*, 168 B.R. 731 (W.D. Ok. 1994) (separate classification allowed; confirmation denied). The parade of horribles portrayed by LICV is sheer fantasy.

LICV argues that if §1122(a) allows separate classification, the §1126(c) definition of acceptance becomes irrelevant. This argument is frivolous. Many definitions in the Code are not relevant in any particular case. No one claims that §1122(a) mandates that every claim be classified separately; §1126(c) remains relevant in every case in which any class contains more than one claim, and would be relevant here under Barakat's proposed Plan as to the five multiple-member classes.

C. The Majority of Circuits Improperly Treat the Plan Proponent's Motivation as Relevant to the Propriety of Classification, and Exhibit an Improper Bias Against Single Asset Real Estate Debtors.

LICV's analysis of the majority rule on classification (Opposition, pgs. 8-11) is telling. The phrases "*legitimate* reason for separate classification," "*legitimate* operating cases," and the loaded pejorative "*gerrymandering*" highlight the majority's unwarranted bias against single asset real estate debtors.

The *Greystone* line of cases assumes, without authority or analysis, the relevance of a plan proponent's motivation in separately classifying a deficiency claim to enhance the likelihood of obtaining an impaired consenting class as required by §1129(a)(10). *In re Gato Realty Trust Corp.*, 183 B.R. 15, 23 (Bankr. D. Mass. 1995); *In re Bloomingdale Partners*, 170 B.R. 984, 995-96 (Bankr. N.D. Ill. 1994).

No court would say that it is manipulative or an abuse of the reorganization process for a plan to propose to pay creditors at least as much as they would receive under Chapter 7,

in a "blatant attempt" to comply with §1129(a)(7). Nor would any court criticize a proponent for proposing a plan that is not likely to be followed by liquidation, in a "transparent effort" to comply with §1129(a)(11), or one that continues retiree benefits just to achieve compliance with §1129(a)(13). Section 1129(a)(10) includes the only safeguard deemed necessary by Congress: acceptances by insiders do not count. This shows that §1129(a)(10) was intended not to give any interest a veto power, but merely to require some indicia of *non-insider* creditor support to proceed to a cramdown hearing. *Woodbrook,* 19 F.3d at 318; *SM 104,* 160 B.R. at 218.

Use of "gerrymandering" to describe separate classification of deficiency claims illustrates the results-oriented analysis of the *Greystone* cases. The right to vote in a Chapter 11 plan does not equal the right to control the plan process. *Rivers End,* 167 B.R. at 478. A better example of improper manipulation of the plan process can be found in the failure of a deficiency claimholder to exercise its §1111(b) election, not because it desires the treatment afforded to unsecured creditors, but because it knows that its claim will overwhelm the unsecured class and thereby torpedo the plan. *Gato Realty,* 183 B.R. at 23.

In "legitimate operating cases" (as distinguished from single asset real estate cases), courts have uniformly allowed separate classification of substantially similar unsecured claims on the basis of different economic motives of creditors. *Matter of Jersey City Medical Center,* 817 F.2d 1055, 1060-61 (3rd Cir. 1987); *U.S. Truck,* 800 F.2d at 587; *In re Chateaugay Corp.,* 155 B.R. 625, 632-35 (Bankr. S.D. N.Y. 1993), *aff'd,* 177 B.R. 176 (S.D. N.Y. 1995); *In re Richard Buick, Inc.,* 126 B.R. 840, 851-52 (Bankr. E.D. Pa. 1991); *Matter of Rochem, Ltd.,* 58 B.R. 641, 643 (Bankr. D. N.J. 1985).

There is nothing "illegitimate" about single asset real estate cases which allows the different restrictions imposed upon such debtors by the *Greystone* line of cases. In the Bankruptcy Reform Act of 1994, Congress imposed certain specific restrictions on single asset real estate debtors at new §362(d)(3). (Petition, pgs. 28-29). Congress did not indicate

that additional distinctions between "legitimate operating cases" and single asset real estate cases were warranted.

LICV asserts that the *Greystone* line of cases "have created a flexible judicial rule which allows for separate classification of a deficiency claim when a court finds there is a legitimate independent business or economic justification for separate classification." (Opposition, p. 11). The Ninth Circuit disagreed, noting that its rule "will effectively bar single asset debtors from utilizing the Bankruptcy Code's cramdown provisions." (Appendix, pg. A-14). As noted in *Baldwin Park*, 171 B.R. at 376, "[t]he problem is that the courts rarely find sufficient evidence to support" a plan proponent's assertion of such economic or business justification. Lower courts do not uniformly apply *Greystone*'s "one clear rule." For example, the result in this case cannot be squared with *Baldwin Park*, nor with *In re Elmwood,* 182 B.R. 845 (D. Nev. 1995) (which allowed separate classification based on differences in plan treatment), nor with *In re Johnston,* 21 F.3d 323 (9th Cir. 1994) (which held separate classification warranted because the claimant was situated differently from other unsecured creditors on a legal basis, just as a §1111(b) deficiency claimant is different from other unsecured creditors). In practice, this "flexible" standard is enforced inconsistently, haphazardly, and ultimately unfairly. Indeed, even if the Seventh Circuit had not bolted from the *Greystone* pack in *Woodbrook*, the inconsistent interpretation of the *Greystone* standard would justify a grant of certiorari here.

IV. THE DELETION OF §1124(3) DOES NOT RESOLVE THE ISSUES PRESENTED.

The elimination of former §1124(3) is of no significance in this case, and would likewise be of no significance in most cases affected by the issue here. LICV blithely asserts that Barakat could seek to meet §1129(a)(10) by creating an administrative convenience class pursuant to §1122(b). This argument overlooks that creation of such a class hinges on the court finding that creation of such a class is, as the statute

requires, "reasonable and necessary for administrative convenience." Unless there are enough small unsecured claims, the threshold determination that such a classification is "necessary for administrative convenience" will not be met. See, e.g., *In re S & W Enters.*, 37 B.R. 153, 162 (Bankr. N.D. Ill. 1984) (convenience class allowed only when not to have one would be burdensome or create complexity).

LICV's suggestion that §1129(a)(10) could be met by an artificially-created convenience class runs counter to *Greystone*-like authority. In *S & W*, the court found that creation of a convenience class was merely to satisfy §1129(a)(10); thus, the court rejected the classification scheme. See also, *In re North Washington Center Ltd. Partnership*, 165 B.R. 805, 809-810 (Bankr. D. Md. 1994). Moreover, the existence of some alternative theory on which Barakat could present a modified plan and proceed to confirmation does not eliminate the conflict among the Circuits on the classification issue actually and squarely presented in this case.

V. LICV WILL NOT BE HARMED BY ANY DELAY OCCASIONED BY GRANTING CERTIORARI.

LICV's contention that it "will suffer substantial actual harm if the Petition is granted" is incorrect. The Ninth Circuit granted Barakat's emergency motion to stay the mandate by Order entered December 30, 1996 (Appendix, pg. A-23). The Order incorporates the terms of the stay issued by the District Court (Appendix, pgs. A-32-35), including *inter alia* the requirement that Barakat pay LICV $27,500 per month, and maintain insurance and tax payments on the subject property. The $27,500 payments are based on an interest rate of 11% per annum, an enhancement of the note rate of 9.625% per annum.

Accordingly, LICV's interest is protected by the stay issued by the Ninth Circuit. If LICV believes that the terms of the stay are inadequate, LICV is free to seek modification of the stay. The fact that LICV will be prevented from foreclosing while this Court determines the issues on the merits is not a sufficient reason to deny certiorari.

VI. CONCLUSION

LICV contends that the Seventh Circuit decision in *Woodbrook* is "anomalous" or "aberrational." It is neither. Many courts and commentators have agreed with *Woodbrook*. But even if *Woodbrook* were anomalous, there remains a Circuit-level conflict on the exact issue presented here.

The claim that the classification issue presented here has little economic effect is wrong. In most single asset real estate cases, deficiency claimholders are financial institutions, while the other unsecured creditors tend to be small, locally-based suppliers and service people. *Greystone*'s grant of veto power to deficiency claimholders tilts the playing field sharply in favor of lender interests and against unsecured small business creditors, individual and small partnership debtors, and their employees. This shift in power does violence to the balance crafted by Congress in enacting the Code. If this issue were unique to Barakat and unlikely to reoccur, there would not be such a volume of contradictory case law and scholarly articles dealing with this issue. LICV's assertion that "many economic and business justifications exist which would facilitate confirmation of a debtor's plan in most situations" is not borne out by case law, which overwhelmingly finds no such justification in single asset real estate cases.

The Opposition fails to state a single cogent reason why exercise of this Court's certiorari jurisdiction would be inappropriate. Accordingly, this Petition for Writ of Certiorari should be granted.

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